CONCLUSION

For the foregoing reasons, GTE and SNET respectfully request that the Commission stay the effectiveness of its rules pending judicial review. At a minimum, the movants request that the Commission stay the effectiveness of the pricing provisions in its rules. In addition, the movants ask that the Commission take action on this motion within 10 days. If the Commission has not acted within that time, the movants intend to seek a stay from the Court of Appeals.

Respectfully submitted,

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Dated: August 28, 1996

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications	)	
Act of 1996	)	

AFFIDAVIT OF DENNIS B. TRIMBLE

STATE OF TEXAS §
§
COUNTY OF DALLAS §

Dennis B. Trimble, being duly sworn according to law, states as follows:

1. My name is Dennis B. Trimble and I am the Assistant Vice President - Marketing Service (Acting) for GTE Telephone Operations ("GTE" or "the Company"). In that capacity I am responsible for, among other matters, analyzing the demand characteristics of GTE's regulated product offerings and developing costs, prices and associated tariff filings for all of GTE's regulated services, inclusive of tariff filing activity with the FCC.

2. I have over 20 years experience with GTE. During this time I have held various positions throughout the Company, almost all related to demand analysis, market research, forecasting, and/or the pricing of regulated telecommunication services. I have a B.A. in Business (1970) and an M.B.A. (1973) both from Washington State University. In 1972, I became an Assistant Professor at the University of Idaho, where I taught courses in statistics, operations research and decision theory. From 1973 through 1976, I completed course work

toward a Ph.D. degree in Business at the University of Washington, majoring in quantitative methods with minors in computer science, research methods, and economics.

3. I have reviewed in detail the Federal Communications Commission's ("FCC") *First Report and Order* which was issued on August 8, 1996. This order establishes a framework of national rules implementing the local competition provisions of the Telecommunications Act of 1996 ("Act").

4. The purpose of this affidavit is twofold: (a) to describe the nature of the cost studies that GTE submitted in the Florida Public Service Commission's ("FPSC") proceeding No. 950985-TP, and that are referenced in the *First Report and Order* (at ¶¶ 793, 808); and (b) to describe the magnitude of GTE's estimates of total joint and common costs that have resulted from the procedures employed by the Company in the development of its various Total Service Long Run Incremental Cost ("TSLRIC") estimates as submitted in various state proceedings.

5. The cost studies that GTE submitted in the Florida Public Service Commission's Docket No. 950985-TP were intended to identify the TSLRIC cost of local loops (both bundled and unbundled) and end office switching. As described below, there are substantive differences between the methodology used in GTE's Florida study and the FCC's Total Element Long Run Incremental Cost ("TELRIC") methodology. The results of GTE's Florida study cannot in any way be construed to produce a result that approximates a TELRIC-based cost that would be appropriate for use in deriving a proxy cost ceiling.

6. The FCC has prescribed that the pricing of network elements shall be based on the TELRIC of the element plus a reasonable share of forward looking joint and common costs. *See* § 51.505.

7. The FCC further defines a reasonable share of forward looking joint and common costs in the development of unbundled network element prices to depend on many factors including the Stand Alone Cost ("SAC") of the element, market demand characteristics, as well as the overall magnitude of the company's forward looking common costs. *First Report and Order* at ¶¶ 694, 695, 696, 698, 699.

8. GTE defines TSLRIC as the additional cost incurred by the Company to produce the entire output of a particular service, holding constant the production of all other services produced by the Company. While this definition is similar to the FCC's implied definition of TELRIC, the FCC has stated that many of the costs that are correctly defined as joint and common costs in the development of TSLRICs can be directly attributed to specific network elements in the development of TELRICs. *First Report and Order* at ¶¶ 678, 682, 694. Thus, the FCC's definition of TELRIC should result in cost estimates that are larger than the TSLRIC for the specific network function that is being studied.

9. GTE's current TSLRIC methodology for services and unbundled elements includes the following expenses: (a) depreciation, (b) return on investment, (c) income taxes, (d) plant specific maintenance and repair, (e) central office land and buildings, (f) customer operations (*e.g.*, sales), and (g) miscellaneous fees and taxes *(e.g.,* ad valorem tax, gross receipts tax). GTE's TSLRIC methodology does not include the following expense items (they are

considered common expenses to the Company): (a) plant specific expenses (*e.g.*, network support, general support, and general purpose computers), (b) plant non-specific expenses (*e.g.*, network planning, engineering), (c) general support assets (*e.g.*, furniture, office support equipment, company communications equipment, and general purpose computers), (d) land and buildings (other than central offices), (e) indirect labor, (f) corporate expenses, and (g) other taxes and fees, such as local franchise taxes, federal superfund taxes, local and state business license and occupation taxes). It is not unusual for these expense categories to represent from 35% to 45% of the Company's total accounting costs. The total amounts in these common cost categories are appropriately excluded from GTE's TSLRIC studies because GTE's USOA-based accounting system records do not contain sufficient information to directly attribute (if appropriate) any of these expenses to specific network elements, and/or there is not a cost-causative method to associate these to specific elements of the network. The USOA-driven accounts, which GTE has identified as representing common costs, might include many items that are, in reality, service (or element) specific. However, as I have previously stated, those costs cannot be separately identified because the USOA-based accounting system does not contain a level of detail sufficient to allow direct attribution of those costs to their appropriate service (or network element). Thus, the USOA-based accounting processes limit GTE from identifying any remaining costs that may belong in the FCC's definition of TELRIC.[1] Paragraph

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[1] It is my professional opinion, that even if GTE possessed an elaborate (and expensive) managerial accounting system that facilitated the direct assignment (when appropriate) of these costs, that GTE considers as common costs, to specific network elements, that this ability would only result in a minor change in the level of GTE's "total" common costs. I believe that the USOA accounts that GTE currently incorporate in its TSLRIC studies represent a vast majority of all directly assignable costs.

694 of the *First Report and Order* states: "Certain common costs are incurred in the provision of network elements. As discussed above, some of these costs are common to only a subset of the elements or services provided by the incumbent LEC's. Such costs shall be allocated to that subset, and should then be allocated among the individual elements of services in that subset, to the greatest possible extent" (*Emphasis added*). GTE's TSLRIC studies do not attempt to perform this allocation of common costs. Allocation of these common costs to specific products for recovery is accomplished through GTE's pricing activities, not through GTE's incremental costing activities. Thus, GTE's TSLRIC methodologies (as currently employed) will lead to incremental cost estimates that are likely to be substantially below what the FCC intended to be incorporated in the development of TELRICs. It is my belief that the FCC has relied upon benchmark prices (and/or costs), as filed in various states, that do not incorporate an allocation of common costs, and thus only represent the incremental cost of a network element and not the total, average cost of that element.

10. As I stated previously, the methodology GTE currently employs to develop its TSLRIC estimates does not incorporate significant levels of joint and common costs. These costs must be recovered through the pricing of services. For California, I submitted testimony that GTE California's forward looking joint and common costs were approximately $1.05 billion annually,[2] which equated to 70% of the total costs identified in GTE's filed TSLRIC estimates. (Thus, GTE California's total economic costs could be recovered by pricing all network elements so that they achieved an average 70% markup over their TSLRIC estimates).

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[2] Source: Rebuttal Testimony of Dennis B. Trimble (Exhibit 313-S, filed July 10, 1996) before the California Public Utilities Commission in Docket No. R.93-04-003/I.93.04.002.

11. In the development of its unbundled loop proxy price (ceiling price) for Florida, the FCC weighted the interim 2-wire unbundled loop rates for BellSouth ($17.00) and United/Centel ($15.00) and the approved rate for GTE ($20.00) as set by the Florida Public Service Commission (FPSC); and computed a state-wide average price of $17.28 based upon the Florida figures. *First Report and Order* at ¶¶ 792, 793. The FCC assumed that the rates ordered by the FPSC were rational proxies for TELRIC plus a reasonable allocation of forward-looking common costs. But, GTEFL's approved rate of $20.00 provides only an insignificant contribution to common costs (approximately 2% above GTEFL's filed TSLRIC estimate and far below the average 70% that would be required in California). The FPSC's order that prescribed GTEFL's $20.00 unbundled loop rate specifically stated "that GTEFL's rates for unbundled loops shall approximate TSLRIC" (Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP, page 31). There was no recognition of reasonable contribution to forward-looking common costs, as discussed by the FCC.

12. United/Centel's cost study for an unbundled loop was found by the FPSC to be inadequate to support the development of rates for an unbundled loop as the costs could not be identified as either LRIC or TSLRIC estimates. Based on judgment, the FPSC set an interim rate of $15.00 for United/Centel and also ordered United/Centel to complete appropriate cost studies (Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP, page 32). The FCC assumed that the $15.00 rate set by the FPSC is a reasonable depiction of United/Centel's TELRIC plus "reasonable allocation of forward-looking common costs" as is required by § 51.505(a)(2). But

as noted above, in setting loop rates the FPSC did not include any reasonable contribution to forward-looking common costs.

13. Likewise, the FPSC found BellSouth's filed cost studies for unbundled elements to be deficient which led the FPSC to set an interim rate of $17.00 for BellSouth's unbundled 2-wire loop. BellSouth was also ordered to file cost studies to support the development of a permanent unbundled loop rate (Docket No. 950984-TP, Order No. PSC-96-0444-FOF-TP, page 19).

14. To meet its own criteria, the FCC's proxy prices should be constructed to reasonably reflect statewide average TELRIC plus "reasonable allocation of forward-looking common costs." However, in the development of Florida's proxy price for unbundled 2-wire loops the FCC relied on FPSC ordered rates. Of the three rates used by the FCC, only GTE's rate had any accepted cost support. Moreover, even GTE's rate did not contain any reasonable contribution as toward joint and common costs as required under the FCC's own pricing guidelines. § 51.505 The FPSC's ordered rates were intended to have little or no contribution above TSLRIC. When this fact is combined with the fact that TELRIC should be higher than TSLRIC (*First Report and Order* at ¶ 678), the obvious conclusion is that the proxy ceiling of $17.28 that the FCC found the studies produce for Florida is too low and that it cannot be construed to be an estimate of TELRIC plus a "reasonable allocation of forward-looking common costs" as is required by § 51.505(a)(2). But the FCC did not use this rate. Instead, its proposed proxy ceiling rate for Florida of $13.68 is apparently calculated from another model

using the unweighted approved Florida rates as a scaling factor. (*Id.* at ¶ 794) The FCC's proxy ceiling for unbundled loops in Florida can only be considered arbitrary and inappropriate.

15. For unbundled switching, the Commission defined the local unbundled switching element to encompass line-side and trunk-side facilities plus all of the features, functions, and capabilities of the switch. (*Id.* at ¶ 412) The line-side facilities include the connection between a loop termination at, for example, a main frame distribution frame (MDF), and a switch line card. The Trunk-side facilities include the connection between, for example, trunk termination at a trunk-side cross-connect panel and a trunk card. The "features, functions, and capabilities" of the local switch include the basic switching function of connecting lines to lines, lines to trunks, trunks to lines, trunks to trunks. It also includes the same basic capabilities that are available to the incumbent LEC's customers, such as a telephone number, directory listing, dial tone, signaling, and access to 911, operator services, and directory assistance. In addition, the local switching element includes all vertical features that the switch is capable of providing, including custom calling, CLASS features, and Centrex, as well as any technically feasible customized routing functions.

16. In the *First Report and Order* (at ¶ 803), the Commission discusses the estimates of the cost for end-office switching. The Commission also discusses the costs and rates for transporting and terminating traffic for interconnection purposes and concludes, that a range between 0.2 cents ($0.002) per minute of use and .4 cents ($0.004) per minute of use for unbundled local switching is a reasonable default proxy. (*Id.* at ¶¶ 805-809, 811) Thus, the

Commission reasoned: "We, therefore, conclude that 0.2 cents ($0.002) per minute of use is a reasonable lower end of the price for end-office switching." (*Id* at ¶ 812)

17. A review of the record relied upon by the Commission in determining the range of proxy rates for the unbundled local element defined in § 51.513 for local switching demonstrates that the Commission used incomplete data for the costs for end-office switching and local interconnection. The costs for the functions that support the rates for end-office switching and local interconnection simply do not match the description of the unbundled local switching element the Commission has laid out. (*First Report and Order* at ¶ 412) The cost studies on which the Commission relied measure only the incremental cost of end office switching for local interconnection. End office switching used for local interconnection only includes the basic switching function of connecting lines to trunks and trunks to lines. There is no cost or rate evidence in the record regarding the remaining features, functions, and capabilities of the switch that are included in the Commission's definition of the unbundled switching element. By relying on studies that take into account the cost of only a fraction of the switching element as defined in the rules, the FCC has established an unreasonably low proxy rate for the local switching element.

18. For unbundled end office switching, the difference between the FCC's objective TELRIC costs and the GTE study filed in Florida are significant. These crucial differences are:

a. First and foremost, the GTE study did not attempt to determine the cost of unbundled end office switching that would be used by a requesting party to provide local exchange service. The study determined only the incremental costs associated with terminating an additional minute of use when two networks are interconnected for the purpose of exchanging traffic,

b. At the time GTE filed its study in Florida it did not have the procedures in place to identify the fixed costs associated with central office land and buildings. As a result, these expenses were not included in GTE's TSLRIC study filed in Florida. This expense item, which is now included on a going-forward basis in GTE's TSLRIC studies, is a significant contributor to the average cost of end-office switching. Central office land and buildings expenses can account for up to 60% of the total TSLRIC of end-office switching.

c. As discussed in paragraph 9 of this Affidavit, GTE's procedure for estimating TSLRICs tends to exclude costs (which GTE has termed as joint and common) that properly belong in what the FCC defines as TELRIC. Again, this further supports the conclusion that GTE's TSLRIC estimates, as filed in Florida, are likely to dramatically understate what the

FCC would term a TELRIC estimate, and would be far less than an estimate of TELRIC plus "a reasonable allocation of forward-looking common costs." § 51.505(a)(2).

Thus, the numbers on which the FCC relied upon are too low because they were based on GTE Florida filed estimates. *First Report and Order* at ¶ 808. By relying on such figures that did not include all of the costs included in the Commission's own TELRIC methodology, the FCC has picked a benchmark number for end-office switching costs that is significantly under-stated.

19. To illustrate this fact, an analysis prepared under my direction compares the FCC's proxy ceiling price for unbundled switching to the actual cost of providing that unbundled feature. This was done by selecting two typical local central office switches and determining the cost per year to operate those switches. The costs are for maintenance, support structures, capital costs, and an average distribution of overheads. These are all costs that the FCC has specified as being appropriate for inclusion in unbundled elements. *See First Report and Order* at ¶¶ 682, 691. These current costs were reduced by 17% of total revenues based upon the FCC's estimate of costs that would be avoided if an ILEC were not in the retail business.[3] The appropriate unit of analysis is the entire central office switch, because the FCC specified the party obtaining a unit of unbundled switching will also have access to all of the features and functions of the switch. The results of the switching cost analysis are shown on Attachment 1.

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[3] From the studies I have reviewed, I believe the costs avoided are less than this amount, but this amount was used to base the analysis on the FCC's own cost avoidance projection.

20. The switching cost analysis shows that, at a price per minute ranging from $.002 to $.004 (the FCC specified proxy ceiling price), the total revenue that would be generated by applying those prices to all local and access minutes of use falls well short of recovering the actual costs of providing the unbundled switching element.[4] The shortfall results from a reliance by the FCC upon cost studies presented to, or decisions made by, state commissions that were designed to estimate the incremental cost of switching one minute of calling exchanged between two networks that are interconnected.[5] I have reviewed the submissions the Commission relied upon to see if those referenced submissions dealt with the cost of all of the elements included in unbundled end office switching under the TELRIC method. Only the Hatfield study purports to include such elements.[6] All other studies addressed the incremental cost of switching used for termination of traffic when two networks are interconnected. These studies ignore the costs of those elements of a switch that are related to serving lines (§ 51.319(c)(1)(C)).

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4 As depicted by "% UNRECOVERED USING PROXY" line on Attachment 1.

5 *First Report and Order* at ¶¶ 803-809.

6 GTE has previously documented the shortcomings of the Hatfield Model. *See First Report and Order* at ¶ 804 and n.1907. Dr. Timothy J. Tardiff reiterates these shortcomings in his Affidavit attached to this Motion. Further, Dr. Tardiff clarifies that the $0.0035 per minute cost figure included within his original "Economic Evaluation of Version 2.2 of the Hatfield Model" is not an estimate of the total average cost, as the Commission claims. *First Report and Order* at ¶ 804. Rather, it is a cost estimate calculated by Dr. Tardiff for the purpose of comparing the output of the Hatfield Model to the Pacific Bell Cost Proxy Model. This estimate was calculated by removing all common costs and other costs (*e.g.*, directory listing) that would be included in an estimate produced by a TELRIC study.

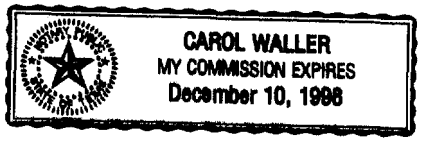
21. Based upon my and my staff's review of the FCC's *First Report and Order*, I am convinced that the FCC's proxy price ceilings for unbundled loops and local switching are significantly understated and in absolute conflict with §§ 51.319(c)(1)(C), 51.503 and 51.505.

Dennis B. Trimble

NOTARY Carol Waller
Signature

CAROL WALLER
Printed Name

SEAL



Date 8-27-96

Attachment 1

Affidavit of Dennis B. Trimble

Central Office Analysis

CENTRAL OFFICE ANALYSIS

ITEM	SAN ANGELO SE @ .004/MIN	SAN ANGELO SE @ .002/MIN	AZLE @.004/MIN	AZLE @ .002/MIN
LINES	17,458	17,458	6,619	6,619
SWITCH INVESTMENT	$7,045,234	$7,045,234	$3,210,000	$3,210,000
MINUTES/MONTH	10,893,753	10,893,753	11,811,072	11,811,072
ANNUAL COSTS				
OPERATING EXPENSES				
MAINTENANCE	$569,748	$569,748	$259,593	$259,593
ADMIN AND OVERHEAD	$1,003,101	$1,003,101	$457,039	$457,039
DEPRECIATION	$177,188	$177,188	$80,732	$80,732
RETURN ON INVEST.	$778,498	$778,498	$354,705	$354,705
COMPOSITE TAX	$59,532	$59,532	$27,125	$27,125
LAND & BUILDINGS	$679,865	$679,865	$309,765	$309,765
PROPERTY TAX	$69,043	$69,043	$31,458	$31,458
TOTAL ANNUAL COST	$3,336,975	$3,336,975	$1,520,417	$1,520,417
LESS 17% AVOIDED	$567,286	$567,286	$258,471	$258,471
ADJUSTED ANNUAL COST	$2,769,689	$2,769,689	$1,261,946	$1,261,946
COST/MO (ANN. COST/12)	$230,807	$230,807	$105,162	$105,162
TELRIC/MIN	$0.004	$0.002	$0.004	$0.002
USAGE REV/MO	$43,575	$21,788	$47,244	$23,622
COMMON COST/MO	$187,232	$209,020	$57,918	$81,540
COMMON COST/LINE/MO	$10.72	$11.97	$8.75	$12.32
% UNRECOVERED USING PROXY	81.1%	90.6%	55.1%	77.5%

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications	)	
Act of 1996	)	

AFFIDAVIT OF TIMOTHY J. TARDIFF

STATE OF MASSACHUSETTS

COUNTY OF MIDDLESEX

Timothy J. Tardiff, being duly sworn according to law, states as follows:

1. My name is Timothy J. Tardiff. I am a Vice President at National Economic Research Associates, 1 Main Street, Cambridge, MA 02142. I received the B.S. degree from the California Institute of Technology in mathematics (with honors) in 1971 and the Ph.D. in Social Science from the University of California, Irvine in 1974. From 1974 to 1979, I was a member of the faculty at the University of California, Davis. I have specialized in telecommunications policy issues for about the last 14 years. My research has included studies of the demand for telephone services, such as local measured service and toll; analysis of the market potential for new telecommunications products and services; assessment of the growing competition for telecommunications services; and evaluation of regulatory frameworks consistent with the growing competitive trends. I have filed testimony and reports on behalf of Pacific Bell before the California Public Utilities Commission on incremental cost principles, rules for local competition, universal service funding, open access and network architecture, regulation of wireless telecommunications services, the treatment of accounting changes for post-retirement benefits under price caps, the review of California's price cap plan, and flexible pricing for

Centrex service and before the Federal Communications Commission on price cap productivity, access to intelligent networks, interconnection pricing policies, and the treatment of accounting changes for post-retirement benefits under price caps. I have also testified for GTE North on intraLATA presubscription before the Illinois Commerce Commission, filed a report with the New York Public Service Commission on intraLATA presubscription on behalf of New York Telephone, and filed a study on the performance of U.S. telephone companies under incentive regulation with the Canadian Radio-television and Telecommunications Commission on behalf of AGT Limited.

2. GTE has asked me to comment on the FCC's use of my report on the Hatfield model to support its proxy-based rate for unbundled local switching.[1] The FCC's interpretation of my findings does not provide a proper basis for establishing a ceiling for the local switching proxy rate. Even though the number that the FCC uses from my study was calculated for a different reason and not designed to provide an estimate of local switching cost, the data provided in my study if used consistently with the rules described in the *First Report and Order* would produce a considerably higher estimate of local switching costs associated with the FCC's unbundled local switching element.

3. The $0.0035 cost per minute for local switch usage presented in my study does *not* represent the cost of unbundled local switching. The purpose of the table that presented the estimate of $0.0035 per minute for local switching was to establish that Version 2.2 of the Hatfield model is fundamentally flawed in a way that understates the true forward-looking costs of providing network elements. To establish this finding, I compared the outputs from Hatfield's model for California with similar values from Pacific Bell's Cost Proxy Model (CPM).

4. The output from the CPM was designed for a somewhat different purpose—to estimate the cost of providing universal service. Accordingly, I performed a number of calculations on

[1] Timothy J. Tardiff, "Economic Evaluation of Version 2.2 of the Hatfield Model," Prepared for GTE Corporation, July 9, 1996. The FCC's August 8, 1996 *First Report and Order* (FCC 96-325) references my report in discussing the ceiling for local switching in paragraphs 804 and 812 and in footnotes 1905 and 1931.

the output of the CPM in order to facilitate a comparison with the Hatfield model's output. In particular, I reduced the total cost of universal service by removing service specific costs (directory assistance and white page listing) and *all* common and shared costs. In addition, the CPM listed local switching costs as monthly amounts for traffic sensitive and non-traffic sensitive items. To convert the traffic sensitive item into a per minute amount to be consistent with the Hatfield model output, I used an approximation of 500 local calling minutes per residential customer.

5. Because the purpose of my calculations was to develop "ball park" estimates derived from the CPM for comparison with Hatfield model estimates, the resulting figures are not equivalent with the output from a forward-looking study that focused specifically on local switching costs. This consideration notwithstanding, it appears that the process established in the *First Report and Order* would lead to per minute costs that are considerably higher than the single number that was pulled from my report.
6. First, my table contained two costs for switching: per line and per minute, while the *First Report* and Order describes only one. This is curious in light of the fact that the FCC's description of the calculation of the per minute charge for local switching from a proper forward-looking economic cost study includes both flat and usage sensitive elements.[2] For example, if the same approximation of local usage were used to add the fixed line costs, the result would be an approximate doubling of the $0.0035 cost estimate that I derived from the CPM for comparison purposes to about $0.007 per minute.
7. Second, I explicitly excluded shared and common costs. A proper share of these costs are included in the Total Element Long Run Incremental Cost (TELRIC) studies specified in the *First Report and Order*.
8. Third, the FCC's unbundled local switching elements incorporates features as well as calling. In contrast, the cost of universal service package measured by the CPM does not include

[2] *First Report and Order*, paragraph 815 and p. B-34.

vertical switching features. Such costs would have to be added to obtain a valid estimate of the unbundled local switching element.

9. Despite the fact that my report was not intended to produce specific costs to be used in setting prices, the main finding of my study remains valid—the Hatfield model systematically underestimates the costs of local exchange network elements. Therefore, results from that model should not be relied upon in determining the proxy costs of any network element, including local switching.

10. My study identified a number of infirmities with Hatfield's local switch model, some of which I repeat here.[3] By selectively using heavily discounted prices for new switches and by assuming that a local service provider would instantly install all of the switching capacity it needs at once, the Hatfield model produces results that are substantially lower than the forward-looking local switching costs that real telephone providers actually incur.

11. The fundamental flaw is that the Hatfield model ignores the fact that LECs buy additional lines for installed switches as well as new lines for new switches. These additional lines cost more, as the study that Hatfield used for his switch prices describes.

> The add-on market continues to retain revenue potential for the suppliers, particularly as the margins on new switches remain below the margins for the add-on market. A digital line shipped and in place will generate hundreds of dollars in add-on software and hardware revenue during the life of the switch. Suppliers can afford to forego losing (sic) a few dollars on the initial line sale in exchange for the increased revenue in the aftermarket, when prices are less likely to be set by competitive bidding.[4]

12. The local switching component of the Hatfield model graphically illustrates the fallacy of its scorched view of cost studies. In order for the approach to produce realistic costs (ignoring the data problems identified earlier), a new entrant would have to serve customers with initial

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[3] The FCC relies on the results of the "greenfield" version of the Hatfield model submitted with MCI's opening comments, rather than on Version 2.2. The switching cost calculation my be somewhat different between the two models, so that my specific criticisms of Version 2.2 may not be completely applicable. It is noteworthy, however, that the "greenfield" version produces estimates of local switching costs that are very similar, and perhaps even lower than those produced by Version 2.2.

lines only and also have the volumes to command the discounts that existing LECs apparently command. The fact that LECs expand their switches as demand grows and the existence of a lucrative aftermarket for this expansion demonstrate that the "instant LECs" posited by the Hatfield model are inconsistent with reality.

13. The problem with Hatfield's underestimation of switching investment is compounded by the use of uneconomically low values for depreciation and the cost-of-capital. The *First Report and Order* (paragraph 686) recognizes that depreciation and cost of capital must be consistent with competitive conditions. The values used in the Hatfield study clearly are not consistent with the increasingly risky competitive environment in which unbundled network elements will be provided.

14. The infirmities in the Hatfield switching cost calculations notwithstanding, the FCC has apparently again overlooked the fixed (port) charges included in the Hatfield report. These costs increase the total cost of local switching by 43 percent. Including these costs in the per minute cost calculation (as the FCC's rules on page B-34 require) would increase the Hatfield-based cost estimate from $0.0018 per minute to $0.0025.

[4] Northern Business Information, *US Central Office Equipment Market—1994*, McGraw-Hill, p. 71.

STATE OF Massachusetts

COUNTY OF Middlesex

I hereby swear, under penalty of perjury that the foregoing is true and correct, to the best of my knowledge and belief.

Timothy J. Tardiff

Timothy J. Tardiff

Subscribed and sworn to before me this 22nd day of August, 1996.

Irene L. Damaro

Notary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications	)	
Act of 1996	)	

AFFIDAVIT OF DONALD W. McLEOD

STATE OF TEXAS §
§
COUNTY OF DALLAS §

Donald W. McLeod, being duly sworn according to law, states as follows:

1. My name is Donald W. McLeod and I am Vice President-Local Competition/Interconnection for GTE Telephone Operations. In that capacity I am responsible for, among other matters, negotiation of agreements with competing carriers under Section 251 and 252 of the Telecommunications Act of 1996 (the "Act"). I have been personally involved in negotiations with AT&T, MCI and Sprint, as well as being responsible for and knowledgeable of all the negotiations set forth on the appendix to this affidavit.

2. Attached to this affidavit as Exhibit 1 is a current and accurate list of all of the ongoing negotiations for interconnection, access to unbundled network elements, or resale to which GTE is a party.

3. Attached to this affidavit as Exhibit 2 is a current and accurate list of all of the ongoing arbitrations for interconnection, access to unbundled network elements, or resale to which GTE is a party.

4. The administrative and ministerial costs of the negotiation process and arbitration procedures required by § 252 are substantial. With regard to negotiations with AT&T alone, GTE estimates that it has expended more than $1 million to reach voluntary agreement with AT&T only with regard to some of the various issues subject to negotiation. The total sum of money that GTE estimates that it has expended thus far on negotiations and arbitrations pursuant to § 252 of the Act is in excess of $3 million.

5. I have over 26 years experience with GTE in the negotiation of agreements between carriers and in the negotiation and settlement of contested proceedings before state regulatory commissions. During this time I have studied the give and take of open negotiations, particularly the process of how each side is willing to recede from its best result for a particular issue to obtain an agreement which, in total, is the most favorable to it. Examples would be the execution of a separations agreement between two carriers or the settlement of a state rate case in which various financial issues are compromised if the parties can agree to a total settlement.

6. I have reviewed in detail the Federal Communications Commission's (FCC) First Report and Order and Second Report and Order which were issued on August 8, 1996. These two orders establish a framework of national rules implementing the local competition provisions of the Act.

7. Sections 251 and 252 of the Act require that the parties attempt to negotiate an agreement in the first instance with mediation and arbitration being involved only when an agreement cannot be reached. This approach allows free market forces to operate to the maximum extent possible in order to create a competitive marketplace that is unbiased by the

prejudices of state and federal government officials and the political process. The FCC's First Report and Order destroys the process created by §§ 251 and 252 and renders the negotiation process meaningless.

8. Parties cannot engage in neutral and unfettered negotiations when government officials promulgate rules and requirements which remove the incentive and motivation of one party to reach an agreement. The creation of exclusive national standards and specific rules applicable to amendment of agreements places the incumbent local exchange carrier in a position where it has absolutely no negotiation ability whatsoever and has destroyed a fair negotiation process.

9. In particular, the establishment of proxy and default prices removes any meaningful price negotiations since the competing carrier has a mandated baseline. The creation of rules which allow carriers to have extensive preexisting rights regarding interconnection, resale and unbundling leaves the incumbent local exchange carrier with nothing left to negotiate. Everything has already been provided to the competing carriers by the FCC and carriers will refuse to negotiate anything short of the mandated national requirements. Moreover, the massive "most favored nation" rights granted by the FCC to the competing carriers further reduces any incentive for the competing carrier to pursue meaningful negotiations. All of the incumbent local exchange carriers negotiating items have already been given away by the FCC before the process concludes. The incumbent LEC sits down at the table when negotiations commence with no cards left to play.